Centre City Development Corporation

REPORT NO. CCDC-09-10

DATE ISSUED:	June 3, 2009
ATTENTION:	Honorable Chair and Members of the Redevelopment Agency Docket of June 9, 2009
ORIGINATING DEPT.:	Centre City Development Corporation
SUBJECT:	Island Market Centre (northwest corner of the block bounded by 13th, 14th and Market streets and Island Avenue) – Notice of Default to Oak Shelter Systems, LLC -- East Village Redevelopment District of the Expansion Sub Area of the Centre City Redevelopment Project
COUNCIL DISTRICT	2
REFERENCE:	None
STAFF CONTACT:	Eri Kameyama, Associate Project Manager, 619-533-7177

REQUESTED ACTION: That the Redevelopment Agency of the City of San Diego ("Agency"): 1) Find Oak Shelter Systems, LLC ("Developer") in default of the Disposition and Development Agreement (DDA) entered into effective September 20, 2004 between the Agency and the Developer for the development of Island Market Centre Project ("Project"); 2) Authorize the Executive Director or designee to issue a Notice of Default to the Developer; and 3) Approve termination of the DDA if the Developer fails to cure the defaults within the appropriate cure periods.

STAFF RECOMMENDATION: That the Agency find the Developer in default of the DDA; authorize the Executive Director or designee to issue a Notice of Default substantially in the form of the draft Notice of Default attached as Attachment B; and approve termination of the DDA if the Developer fails to cure the defaults within the appropriate cure periods.

SUMMARY: The Agency entered into a DDA with the Developer effective September 20, 2004 for the development and construction of a mixed-use development that includes 164 market-rate and affordable for-sale housing units, 8,000 square feet of retail space and three stories of underground parking on the 40,000 square-foot site located on the northwest corner of the block bounded by 13th, 14th and Market streets and Island Avenue. Staff determined that the Developer failed to perform in accordance with the provisions of the DDA, as specified in the Notice of Default. Staff recommends that the Agency approve the issuance of the Notice of Default to the Developer. The Developer would be given appropriate cure periods for each default that it committed. Staff also recommends that the DDA be terminated if the Developer fails to cure the defaults within the cure periods.

FISCAL CONSIDERATIONS: If the Developer fails to cure its defaults within the applicable cure periods, the Agency is entitled to retain the $50,000 deposit submitted by the Developer as minimum damages per the DDA.

CENTRE CITY DEVELOPMENT CORPORATION RECOMMENDATION: On January 21, 2009, the Centre City Development Corporation ("Corporation") voted 5-1 to recommend the issuance of a Notice of Default to the Developer.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS: None.

DEVELOPMENT TEAM

ROLE	FIRM/CONTACT	OWNERSHIP
Developer	Oak Shelter Systems, LLC Wilmer Cooks	Wilmer Cooks, Nancy Calverley, Martin Weinstein, and Tovik Liberman

BACKGROUND

On September 20, 2004, the Agency entered into a DDA with the Developer to develop and construct a mixed-use project with a combination of 131 market-rate condominiums, 33 affordable for-sale units, 8,000 square feet of retail space and three levels of underground parking on the 40,000 square-foot site located at the northwest corner of the block bounded by 13th, 14th and Market streets and Island Avenue.

The Project site consists of nine parcels (Attachment A). At the time of the DDA execution, the Agency owned three of nine parcels. Pursuant to the terms of the DDA, the Agency was to complete the land assembly and sell the property to the Developer contingent upon the Developer's payment of $3.0 million to the Agency as a purchase price. In the event the total acquisition costs exceeded $8.9 million, the Developer was responsible for all acquisition costs above the Agency maximum contribution of $5.9 million.

The Agency received a $50,000 good faith deposit upon execution of the Exclusive Negotiation Agreement, which was applicable toward the purchase price. Per the DDA (Section 203b), the remaining purchase price of $2,950,000 was due to the Agency upon the Developer's execution and delivery of the DDA to the Agency. The purchase price was intended to reimburse the Agency for a portion of the costs and expenses associated with the acquisition of the site, including acquisition and relocation expenses, fees for the Agency's legal counsel, financial consultants, engineers and other expenses necessary to deliver the Project site to the Developer.

The Developer unsuccessfully attempted to obtain acquisition financing and thus failed to deliver the payment to the Agency. Meanwhile, the Agency proceeded with land assembly and acquired

two additional parcels with Agency funds. The Agency has spent a total of $5.6 million to acquire the five parcels.

The Developer experienced difficulties securing the required financing to develop the Project following the execution of the DDA. The Developer reported that increases in the construction and acquisition costs made the Project infeasible. The Developer proposed revisions to the terms and scope of the DDA in an effort to create a feasible development scenario. The Corporation's Real Estate Committee ("Committee") reviewed such requests (June 2005 and January 2006). The Committee raised concerns on the significant changes made to the original proposal. The Committee requested the unit mix and components included in the original proposal be retained and changes to the proposal be reviewed with parameters of the initial selection criteria from the Request for Proposals (RFP) process. The Committee also requested that the best financial strategy be prepared to minimize the Agency financial participation.

In September 2005, the Developer formed a partnership with SRM Development (SRM) to strengthen its financial and technical capacity to complete the Project. SRM submitted a new proposal in August 2006, which explored six scenarios. Of the six, two were considered to provide returns acceptable to its investors.

Scenario one was based upon the original design and unit mix and an Agency subsidy of $350,000 per affordable unit. Agency subsidies provided for affordable housing projects (new construction) completed between 2004 and 2007 ranged from $90,000 to $120,000 per affordable unit. The developer's proposal to repay the Agency's subsidy in whole or in part by receipt of 60 percent of the net sales proceeds of the units was deemed to be a very risky proposal for the Agency.

Scenario two contemplated redesigning the Project; major changes to the unit mix; and increasing the total number of units by reducing the size of units. Scenario two was not acceptable because it changed the original concept, which was to provide large units targeted for families. In addition, the required Agency subsidy was high ($250,000 per affordable unit). After careful review and discussions with the development team, it was concluded by Corporation staff and consultant team that the Project as originally proposed was no longer feasible and negotiations with the Developer were suspended.

DISCUSSION

The Agency has complied with all of its obligations under the DDA, but the Developer has not fulfilled its obligations in several respects. At this time, there is no evidence or reasonable expectation that the Developer would be able to successfully execute the Project. The Developer is in default of the following terms of the DDA, and it is recommended that a Notice of Default be issued by the Agency.

1. Failure to pay the Developer's Advance to the Agency in accordance with Section 203(b)(1) of the DDA;

2. Failure to submit to the Agency for approval evidence of financing described in the Method of Financing in accordance with the Schedule of Performance;

3. Failure to prepare and submit to the Agency for approval the 100% Design Development Drawings in accordance with the Schedule of Performance; and

4. Failure to satisfy all conditions precedent to the Closing to be satisfied by the Developer in accordance with the Schedule of Performance.

Per Section 501(c) and (d) of the DDA, the Developer would be given 30 days to cure default #1 and 90 days to cure defaults #2-4 above following the Developer's receipt of the Notice of Default. If the Developer fails to cure any one of the defaults within the applicable cure periods, the DDA would be terminated without further notice pursuant to Section 510 (a) of the DDA. In this case, the Agency may retain the $50,000 deposit as minimum damages and pursue all other remedies available to the Agency. A draft Notice of Default was prepared in accordance with the terms and provisions of the DDA (Attachment B).

Environmental Impact – This activity is not a "project" under the definition set forth in CEQA Guidelines Section 15378. Therefore, pursuant to CEQA Guidelines Section 15060(c)(3), the activity is not subject to CEQA. This action will terminate a proposed project.

CONCLUSION

The Developer committed a series of defaults under the DDA. Staff recommends that the Agency find the Developer in default of the DDA, authorize the Executive Director or designee to issue a Notice of Default substantially in the form of the draft Notice of Default attached as Attachment B and approve termination of the DDA if the Developer fails to cure the defaults within the appropriate cure periods.

Respectfully submitted,

Eri Kameyama
Associate Project Manager

Concurred by:

Frank J. Alessi
Senior Vice President & Chief Financial Officer

Attachments: A – Site Map
B – Draft Notice of Default